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SUBJECT: U.S. VENTURE SEEKS FOR-PROFIT RURAL HEALTH CLINIC NETWORK IN SW CHINA

REF: A) CHENGDU 155, B) CHENGDU 229

CHENGDU 00000231 001.2 OF 003

¶1. (U) This cable contains business confidential information, not for distribution on the Internet.

¶2. (SBU) Summary: To address the lack of adequate rural healthcare in SW China, a U.S. firm seeks to establish a for-profit network of clinics using a telemedicine and "barefoot doctor" model borrowed from Alaska. While publically financed in Alaska, the model could be profitable in China due to the enormous rural population and few business competitors, the firm's executives believe. Major challenges include: a lack of doctors willing to staff such clinics, PRC capitalization regulations for joint ventures that favor large hospital enterprises over small clinics, and rules against franchising. Consul General offered to seek high-level provincial appointments on their behalf in Chengdu and Chongqing to seek regulatory exemptions for the firm in the context of an urban-rural integration pilot program. End Summary.

¶3. (U) Bart Daniel, Chief Executive Officer and CFO of Eastern Spring Healthcare Services, Inc., and Dr. Jonathan Osborne, Chairman, briefed Consul General, Senior Commercial Officer, and PolEconOff October 14 on their young company's plan to develop a for-profit network of rural healthcare clinics in Sichuan Province. Daniel spent 25 years working in hospital administration, including work as an administrator for the Alaska Area Native Health Care Service, before coming to China in 2003 as Chief Financial Officer for United Family Hospitals (UFH).

Daniel: China Not Yet Ready for a Charity Model
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¶4. (U) Eastern Spring's current venture owes much to Daniel's failed first venture to establish a charity hospital, he said. Daniel and his wife, president of UFH's foundation, helped to establish China's first charity children's hospital in Zhengzhou in 2007. The couple did not foresee the immense capital costs required, however, and had to use virtually all of their savings before securing support from corporate social responsibility projects (CSR) and individual donors back home. The project ultimately had to close down, he said, as the Chinese government asked multinational companies to redirect their CSR work to areas affected by the Sichuan earthquake just as the private donor base in the United States was drying up due to the global financial crisis.

¶5. (U) In Daniel's view, China is not yet ready for a charity model for non-profit organizations. China's richest citizens are too close to coming out of abject poverty, he argued, "it's too soon." The Sichuan earthquake may have been a watershed event, as it was the first time China saw philanthropic activity

by its citizens on a large scale. Yan Cheung, founder and chairwoman of top Chinese waste-paper recycler Nine Dragons Paper and the richest woman in China at roughly USD 5 billion, told Daniel she wanted to be the next Bill Gates, but was "not rich enough yet" to donate more to his charity hospital.

To Address Rural Health, Must Reach the Village Level

¶6. (SBU) Daniel's new venture, Eastern Spring, seeks to address the lack of decent healthcare in rural areas of China, but the absence of a charity model means a different financing mechanism is necessary. To address rural health, you have to reach the village level, he said. Eastern Spring's goal is to establish a for-profit network of rural healthcare clinics in southwest China, with a possible initial public offering (IPO) down the road to attract additional investment. The system they envisage would rely on telemedicine to connect rural clinics to urban hospitals, such as the well respected Huaxi Hospital in Chengdu. (In addition, Eastern Spring hopes to open a healthcare consulting service and a Basic Life Support training center for local first responders, multinational corporations, schools, and extreme sports organizations.)

Using Alaska's Model: Telemedicine and Barefoot Doctors

¶7. (U) The real problem Eastern Spring faces in China, he continued, is how to capture consistency and quality in its business model. A significant barrier to establishing a telemedicine network is the current lack of practitioners in rural areas who could staff these clinics. Doctors are unwilling to move to rural areas of China because there is a dearth of decent schools for their children to attend. The plan, therefore, would require extensive training, Daniel conceded.

¶8. (U) Drawing from his own experience, Daniel offered the example of Alaska for how such rural healthcare challenges could be met. Alaska probably has the premiere rural healthcare system in the United States, he said, providing services to 350-400,000 people thanks in large part to former Senator Ted Stevens' ability to secure Federal funds for financing the system. Alaska faced the same issue of lack of schools in rural areas deterring doctors, so they moved to a telemedicine model that now includes tele-radiology, e-prescriptions, and electronic medical records.

¶9. (U) Even earlier, Alaska started developing its own "barefoot doctor" program in the 1950s, called the Community Health Aide (CHA) Program, officially recognized and federally funded in 1968 and currently certified by Medicare and other major certifiers. According to Daniel, high school graduates are put through a three-month intensive training followed by two years of ongoing on-the-job training. The practitioners, called Community Health Aide/Practitioners (CHA/Ps), are taught how to take a good medical history and then use the 2000-page standardized, algorithm-based Alaska Community Health Aide/Practitioner Manual to work through to a diagnosis and treatment under the constant supervision of a licensed doctor at the other end of a telemedicine system.

Alaska + China = Profitability, Maybe

¶10. (SBU) What makes this publically-financed system work as the basis of a profitable plan for China is that rural villages in China have 40-50,000 people instead of just 200, Daniel said, providing for economies of scale. Eastern Spring's model requires a village with a minimum population of 40,000 and a minimum per capita GDP of RMB 10,000 (USD 1464) in order to be profitable. With an investment of USD 75,000 per clinic Eastern Spring can be operational, and after three years can net USD 25,000 per clinic. "In China, you can make your money back in

two-and-a-half years if you're doing it right," he added.

Current Regulations Mean No Clinics Yet

¶11. (U) The biggest legal impediments, Daniel said, are joint-venture regulations for medical institutions that were designed with UFH and other large hospitals in mind, and which:

-- require a 70-30 foreign/Chinese split and RMB 20 million (USD 3 million) registered investment per facility; and,

-- prohibit franchising (Supplementary Provisions to the Interim Measures for the Administration of Chinese-foreign Equity Joint and Cooperative Joint Medical Institutions, adopted by the Ministries of Health and Commerce).

¶12. (SBU) One option would be to use what Daniel termed a "captive domestic ownership" model, in which the venture has a domestic Chinese owner and everything is completely mortgaged. Though it is a "proven model" used by UFH, he continued, venture capitalists find it too risky. Eastern Spring hopes instead to find relief under the National Development and Reform Commission's new strategic initiatives for healthcare, which included an announcement in April 2009 allowing for "pilot programs," he said. Eastern Spring plans to request an exemption to the current regulations, arguing they could bring in USD 3 million over three years and develop clinics accordingly. At this stage, Eastern Spring has achieved Wholly-Owned Foreign Enterprise (WOFE) status and is doing some consulting in Chengdu, but is primarily engaged in raising funds (through friends, family, and angel investors) while taking time to build relationships with key officials.

Eastern Spring See No Chinese Competition

¶13. (SBU) Asked by CG what interest the central or local government would have in making special provisions for the venture versus protecting local competition, Daniel said PRC officials believe Eastern Spring will see limited profits and that there is no competition. (Note: Ref A discussed Cisco Systems' CSR-funded rural telemedicine project in quake-affected areas. End Note.) China's only interest is in hospitals, not actual functioning clinics, Osborne argued, as the PRC system lacks preventative care. "China is great at hardware," he added, opining that recent upgrades to 29,000 clinics across China improved facilities without improving care.

¶14. (SBU) Consul General suggested Eastern Spring explore finding room to maneuver within the Chongqing and Chengdu urban-rural reform pilot programs (ref B), as the venture's

proposal seems consistent with the thrust of the pilots. Daniel accepted CG's offer to seek appointments on their behalf with the Chongqing and Chengdu governments to advocate for market access.
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